Miguel Urrutia Montoya: Declaration of the main aspects of the National General Budget Project

Declaration of Dr Miguel Urrutia Montoya, Governor of Banco de la República (Bank of the Republic), in the joint session of economical commissions regarding law project concerning national budget of 2005, Bogotá, 11 August 2004.

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Following are the main aspects of National General Budget Project (GBP) presented by the government to the Congress. The macroeconomic consistency of the fiscal data and the sustainability of the debt in a middle term basis are evaluated.

I. Budget project for 2005

The GBP, for the year 2005 is of $93,1 billions, (b) which means an increase of a nominal 15,4% (10,1% real) in front of the budget for year 2004.[1] This increment is explained basically by the increase of pensions obligations in the head of the Nation (37,4%), and the debt service (16,2%). These two concepts, plus the budget for the Participation General System (territorial transferences), with a 7,6% growth, explain the 67% of the GBP.

A. Incomes

In order to finance the budget, incomes of $91,6 b were appraised and the remaining $1,5 b correspond to a complementary budget subjected to approval of the tributary reform that the government presented to congress recently.

Of the $91,6 b of appraised incomes, $84,1 b was resources of the nation and $7,5 b revenues of the national public establishments. Of total resources of the nation, $39 b will be from ordinary incomes, $3,8 b of non-tax revenues and special funds and $41,3 b of capital resources. The following aspects should be emphasized:

1. 82% of current incomes are represented by external and internal AVT (Added Value Tax) and by tax on incomes (each one provides approximately 41% of the total).
2. Capital recourses will be constituted by:
    - External credit projected disbursements for an amount of $9,7 b (US$ 3.500 m).
    - Internal credit disbursements for an amount of $19,9 b (mainly TES) that includes the emission of $2,5 b of TES for covering technical reserve of the ISS. Net financing with TES would be close to $7,8 b, of the projected capital expiration given ($12,1 b).
    - Actives expropriation for $2,8 b. However, it is not clear the availability of these resources, because valuation and sales strategies over the actives affected has not been done.
    - Other resources of capital $6,6 b. Of this amount there is not a clear manner yet for obtaining these $1,9 b that according to budget project, the government hopes to receive in the following months, budget initial funds (searching) of 2005.

[1] For comparative purposes, in the last four years the Budget has increased an average of 5,4% per year in real terms (and 4,7% without including the debt service).

B. Appropriations

Regarding expenditures point of view, 53% of the resources of the GBP are assigned to operations ($49,1 b), 35% to debt service ($32 b) and 13,0% to inversion ($ 11,7 b).

1. The appropriations for operations are divided in the following manner:

    a. Personal services ($ 9,5 b), with an annual increment of 8,3%. A salary appreciation of 5,7% is assumed and an increase in the expenditures of police and military personnel of 10,8% due among other things to the promotion foreseen in the roll.

    b. General expenditures ($2,8 b). Its annual variation of 3,9%, reflects mainly the appropriations for Defense Ministry and National Police whose projected growth is of 11,9%.

    c. Appropriations for transferences ($36,2 b), that represent 39% of total amount of the resources are represented in:

        - Participation general system (territorial transferences), whose annual growth is of 7,6%.
        - Pensions payments for a value of $11,6 b, with an appreciation of 37,4% against that of 2004, including $4,1 b of the transference of the National Government to Instituto de los Seguros Sociales (ISS) due to the depletion of its technical reserves. These transferences will be covered mainly with complementary budget resources ($1,5 b) and the emission of TES agreed, for an amount of $2,5 b.
        - If other items associated to pensions, (classified in “other transferences”) such as teaching funds, Fonpet and other concepts, are added to pensions payment, *the total of budget resources assigned to pensions would ascend to an amount of $16,0 b, equivalent to 17% of the budget*.

2. The expenditures for covering debt service increases to 16,2% against that of 2004. Of these, external debt service grows to 9,9% and the internal debt to 20,0% due mainly to capital expiration estimated in $12,1 b (23,2% more than in 2004).

3. Appropriations for inversion expenditures will ascend to $11,7 b in 2005, $5,2 b that correspond to inflexible items generated through future validities or laws.

II. Macroeconomic coherence

Budget numbers (that are in accordance with Financial Plan of 2005), assume a lesser deficit in the public sector consolidated that would pass from 2,5% to 2,4% of the GDP between 2004 and 2005 and a deficit in payment balance drawing account that would increase from 1,8% to 3,0% of the GDP in those same years. According to the exercise of macroeconomic programming, a higher external saving and the fact that in public sector no resources absorption is had, this implies that private expenditures have a higher space for growing.

The above mentioned is explained because the lower net internal credit demand by the public sector (that would pass from 1,4% to 1,0% of the GDP), would permit the private sector to dispose of higher financing resources. In this manner, according to programming exercise, financial system credit offer to the private sector could grow in an annual rate of 13,2%, 4,0 percent points above the nominal GDP growth (9,2%).

These numbers show that private expenditure in consumptions and inversion would continue being the economical growth motor, compensating the reductions foreseen in public inversion and low growth of real exportations (due mainly to lower incomes from petrol exportations). This higher expenditure would change the net financial position of private sector against the other sectors and would become the net receiver of the resources of 2005 (equivalent to 0,5% of the GDP), for the first time in six years. In this period as an average, the private sector has lent resources to the economy for a 2,6% of the GDP.

As a conclusion, 2005 Budget is coherent with macroeconomic and employment scenery in an economic activity recovery, based on higher expenditures from the private sector. This expenditure expansion is possible *under the assumption that in 2005 the economy will have access to external* *capital flows that will permit the financing of a higher deficit in drawing account.* However, if there are access restrictions to international financing markets, internal financing capacity of private and public sectors could be seriously affected and this would cause a negative impact on economic growth.

III. Year 2005 debt sustainability and budget

Debt sustainability depends on the generation of a primary balance required that will stabilize or reduce the in force debt (as a proportion of the GDP), given economic growth rates and a mean real rate interest (internal and external) to which the external debt must serve itself and the one contracted in the future. Primary balance calculations required are also affected by the evolution of the exchange rate.

According to fiscal projections of Treasury Minister recently presented, primary balance required should be of 2,9% of the GDP for the period 2006 to 2015 (Basic scenery with an economical growth of 4,0% and a real interest rate of 6,0%). With this level of primary surplus, the debt/GDP relation would change from 50,5% of the GDP in 2004 to a 38,6% in 2015.

It should be emphasized that this primary balance would stabilize the debt, even if some negative impacts that the economy could pass through occur. In that manner, for example, in the worst scenery (with a growth of 0% during 2005 and 2006, and a higher rate interest), the debt would stabilize in 55,0% of the GDP in 2015.

Regarding the above mentioned sustainability calculations, the following aspects should be emphasized:

1. For the years 2004 and 2005 it is estimated that consolidated public sectors will generate a primary surplus of 2,7% and 3,0% of the GDP, that are coherent with a sustainable public debt. However, the Central Government will continue generating a primary deficit of 1,1% and 1,9% each year respectively. Therefore, the rest of the public sector will be in charge of compensating these important unbalances. If these fiscal projections are complied, there will be no sustainability problems in the public debt, due to the fact that non-financed public sector balance (SPNF) projected for these, years is close to the one required.
2. However the sustainability of the public debt, in the middle term requires the generation of resources that *in a permanent manner will guarantee the maintenance of a primary surplus of 2,9% for the public sector*. In the figures of Treasury Minister, incomes projections are based on taxes created with a transitory character with an expiration date of 2007 (this is the case for patrimony tax, incomes over taxation and the addition of one point in financial movements taxes). Therefore, the government will at some moment consider formulas for compensating the drop of these incomes. If this were not done, primary balance would diminish in the same proportion, which would cause that public debt be managed in a more complex manner in the future.
3. Surplus foreseen in the non-centralized sector depends mainly of Ecopetrol's finances and the sector of Social Security. In the case of Ecopetrol its fiscal performance is conditioned by different types of contingencies, such as the finding of new crude oil reserves, the evolution of international crude oil prices and exchanger rate behavior.
4. The fiscal deterioration of the ISS, whose pensions obligations will have to be covered in great part by budget appropriations due to the depletion of its reserves, makes it mandatory the approval of the pensions general regime reform project, as well as the elimination of special pension regime. It must be emphasized that these reforms will have an impact on the mean and long terms because future deficits in Social Security will be diminished. However, the cash flow deficit that exists requires complementary measures, not only in incomes but in expenditures as well. Otherwise, the fiscal situation will continue being highly vulnerable.
5. It should be noticed the great negative impact that devaluation would have over public debt, whose trajectory is highly sensible to variations in the exchange rate. For this reason, a big part of the positive effect that a real devaluation has over net exportations may be offset with the negative impact over public debt and possibly over the confidence of the agents upon consequent deterioration of debt indicators. In this sense, an appreciation over real exchange rate must be accompanied with higher fiscal surpluses (or lower deficit) so that it will not have a negative impact over the economy.

Synthesizing, in the fastest and highest grade that fiscal problem is resolved, it will be more feasible that the economy will have high economic growth, lower real interest rates and more competitive levels in real exchange rates without affecting in a negative manner public debt dynamics. Otherwise, primary surpluses required in the future will be higher and therefore the costs in which the society must incur to obtain them will be higher.